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Supreme Court of the United States

October Term, 1970

No. 1098

GARFIELD & CO.,

Petitioner,

against

FANCIS J. WEST,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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No.

GARFIELD & Co.,

Petitioner,

against

FRANCIS J. WIEST,

Respondent.

PETITION FOR WRIT OF CERTIORARI

To the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Garfield & Co. respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit affirming the judgment entered by the United States District Court for the Southern District of New York in favor of the respondent, Francis J. Wiest, and against petitioner, Garfield & Co., for $73,477.97, said judgment having been entered on an order of the Court denying petitioner's motion to vacate an arbitration award and granting respondent's motion to enter judgment on the award.

Opinions Below

The opinion of the District Court is reported at 308 F. Supp. 1107 (1970) and that of the Court of Appeals is not yet reported. Copies of these opinions are appended hereto at pages 1a-10a and 11a-20a, respectively.

Jurisdiction

The order of the Court of Appeals denying petitioner's petition for rehearing was entered on November 10, 1970. The jurisdiction of this Court is invoked under Title 28 U.S.C. § 1254(1).

Questions Presented

1. There being an inconsistency between the arbitration provisions of the Constitution of the New York Stock Exchange and § 10 of the United States Arbitration Act as applied to the facts of this case, which controls?

2. Shall the principle established by this Court in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145 (1968), be to a substantial extent nullified by requirements of advance waiver as a condition of membership in the New York Stock Exchange and similar organizations?

Statutes Involved

United States Arbitration Act § 10 provides that a United States court may vacate an arbitration award when it has been procured by "undue means" (subsection [a]), or when there has been "evident partiality . . . in the arbitrators" (subsection [b]). Petitioner invoked the jurisdiction of the District Court under § 10.

§ 28(b) of the Securities Exchange Act of 1934 (Title 15, U.S.C. § 78bb[b]):

> "Nothing in this Act (chapter) shall be construed to modify existing law (1) with the regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members . . ."

§ 29(a) (§ 78cc[a]):

> "Any condition, stipulation or provision binding any person to waive compliance with any provision of this Act (chapter) . . . shall be void."

Statement of the Case

We adopt the following two paragraphs of the opinion of the Court of Appeals (12a):

"Petitioner-appellant Garfield is a member firm of the New York Stock Exchange (Exchange). It is a small firm with three general partners and one limited partner. Respondent-appellee had formerly been a partner in Garfield & Co. but resigned and joined another member of the Exchange, the firm of Spear, Leeds & Kellogg. The latter is a large firm and was a specialist in 61 stocks, some of which were quite actively traded, before Wiest joined the firm. Mr. Kellogg, the leading partner of the firm, is a former Chairman of the Board of Governors of the Exchange.

"The present dispute arose out of the above-mentioned change of firms by Wiest. Seeking his share of the proceeds of the transfer of an Exchange membership and certain salary and other amounts due him under the terms of the Garfield & Co. partnership agreement, Wiest sent the Arbitration Director of the Exchange a claim against Garfield for $75,719, exclusive of interest and costs. Garfield denied most of this liability and counterclaimed for $250,000 damages for the business expectancy in certain listed stocks in which Wiest had become the Exchange specialist by the use of funds allegedly provided by Garfield. The theory of the counterclaim was that there had been a conspiracy entered into between Wiest and Mr. Kellogg while Wiest was a partner in Garfield by which Wiest would leave Garfield and join Spear, Leeds &

Kellogg, taking with him the status of specialist in eight stocks."

In accordance with the requirements of the Constitution of the New York Stock Exchange, petitioner's partnership agreement provided that any dispute should be settled in New York by arbitration in accordance with the Constitution and Rules of the Exchange (13a).

The Constitution and Rules of the Exchange provided that arbitration should be before a panel of five members selected from a board appointed by the Chairman of the Board of Governors (13a-14a).

Article VIII, § 7 of the Constitution provided (14a):

> "The arbitrators in any case may at any time during the proceeding dismiss the proceeding and refer the parties to their remedies at law."

The first hearing was on March 7, 1968. The panel comprised five members of the Exchange (R.* 36a-37a). Counsel for the petitioner, concerned about the business dealings between the arbitrators and Spear, Leeds & Kellogg, particularly in the light of Mr. Kellogg's double status as alleged co-conspirator and former Chairman of the Board of Governors, were fearful that the panel would be prejudiced in respondent's favor. Although not alleging prejudice in so many words, counsel for the petitioner at the inception of the hearing moved that the arbitrators "refer the parties to their remedies at law" on the authority of Article VIII, § 7, and continued (5a; R. 11a):

> "First, a party of the other side, a partner of Mr. Wiest, a person whose conduct I shall feel called upon to criticize in the course of the proceedings, is a very well known member of the Exchange, Mr. Kellogg, former Chairman of the Board of Governors. Mr. Garfield, on the other hand, is

* R. citations are to petitioner's appendix in the Court of Appeals. No statement of fact so cited is in dispute.

> a relatively little known member of the Exchange and I doubt very much if any of you have had occasion to do business with him. On the other hand, I am sure that you all have had reason to do business, and perhaps regularly to do business, with Spear, Leeds & Kellogg, of which Mr. Kellogg is the leading partner."

The Chairman of the panel replied to counsel "to reassure" him that, in substance, "knowing one man is entirely familiar to the Arbitrators and I don't think any of them have favoritism on their consciences" (6a). No disclosure of business dealings was made. The arbitrators then denied the motion and the arbitration hearings proceeded through November 20, 1968. On December 19, 1968 the arbitrators made an award to the respondent to the extent of $68,925.29 and by a divided vote dismissed the counterclaim (15a; R. 18a).

Meanwhile, on November 18, 1968 this Court decided the *Commonwealth Coatings* case, 393 U.S. 145.

Petitioner then in January, 1969 filed a petition in the District Court to vacate the award on the ground that there had almost certainly been business dealings between the arbitrators' firms and Spear, Leeds & Kellogg, and that (R. 13a):

> "37. Upon information and belief, the Arbitrators herein were duty bound, especially upon the making of the motion described above, to disclose their respective business relations with the Kellogg firm of which respondent was a member. They failed or omitted to do so, or, on information and belief, believed that they were under no duty to do so. 38. Upon information and belief, that duty of the Arbitrators was disregarded in this arbitration."

Respondent cross-moved to confirm the award (12a).

The District Court denied the petition to vacate and granted the motion to confirm on procedural grounds rejected by the Court of Appeals (17a-18a).

The Decision of the Court of Appeals: § 10 Rights waived by joining the Exchange

The Court of Appeals affirmed the judgment (20a). The Court, differing from the District Court, found that petitioner had "properly and timely raised his objections under the circumstances and the then existing state of the law" (17a-18a).

The Court's affirmance went on the broad ground that objections to business dealings "were waived in advance by Garfield and by all other members of the Exchange." The Court recognized that "Exchange arbitrators would usually have more substantial contacts with large member firms than with small member firms. While we find rather unrealistic the Exchange's contention in its *amicus* brief that there is no possibility of favoritism by specialists, it would appear that any objections to arbitrators based upon their dealings through specialists are waived by member firms when they agree to Exchange arbitration; such dealings are contemplated by the parties when they join the Exchange" (18a-19a).

The Court did say, however, that in an Exchange arbitration an arbitrator would be "required to disclose any dealings he may have had with the party which were dealings *not* [emphasis in original] in the ordinary course of Exchange business" (20a).

The Court's misconception of petitioner's position. The Court apparently conceived that petitioner objects only to the arbitrators' failure to disclose a "particular type of transactions" *viz.* dealings in the ordinary course of business (16a). Petitioner objects to the arbitrators' failure to disclose any transactions, *supra* page 5. Petitioner makes "no claim that there were [other] dealings" (19a) because petitioner has no such evidence, but petitioner does not rule out that possibility. Mr. Kellogg undoubtedly en-

gages in dealings out of the regular course of business as petitioner knows to its sorrow. One of them was what the arbitration was about.

Reasons Relied on for the Allowance of the Writ

Petitioner submits that the decision of the Court below substantially nullifies the decision of this Court in *Commonwealth Coatings* not only by removing from its scope arbitrations required by the Constitution of the New York Stock Exchange irrespective of "impression of possible bias" and by the rules of all other trade associations with similar arbitration procedures, but also such arbitrations as may be held pursuant to contracts in which one of the parties by superior negotiating power, pressure, cajolery or otherwise has successfully inserted language purporting to waive or otherwise inconsistent with rights under § 10 of the Arbitration Act as construed by this Court.

Argument

In *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968), this Court, acting under the authority of § 10 of the Arbitration Act, vacated an arbitration award on the ground that nontrivial business dealings between a party and an arbitrator "create an impression of possible bias." By inference the Court held that such dealings showed "undue means" and "evident partiality" in the making of the award.

The Business Dealings Here Involved Most Decidedly "Create an Impression of Possible Bias."

At the time of the arbitration the firm of Spear, Leeds & Kellogg, were the specialists in, that is to say, had a prac-

tical monopoly in the dealings in 69 stocks,* nearly five per cent of all those listed on the Exchange, and including such active and important ones as Phelps Dodge, American Airlines, Boeing, Safeway Stores and Union Oil Co. of California (12a; R. 15a-17a).

Mr. Kellogg, leading partner in this firm and former Chairman of the Board of Governors, was, on petitioner's theory of the case, a co-conspirator with respondent in a breach of his fiduciary relationship with petitioner costing it $250,000 by reason of loss of prospective business (13a).

Some effort was made by the Exchange, in its *amicus* brief in the Court of Appeals, to depict the specialist as a mere clerk or automaton, without the capacity to do favors. This thesis was without support in the record.

On the contrary. The specialist is required by Rule 104 to maintain "insofar as reasonably practicable, . . . a fair and orderly market" and to "engage to a reasonable degree under existing circumstances in dealings for his own account when lack of price continuity, lack of depth or disparity between supply and demand exists or is reasonably to be anticipated."

Obviously the performance of these functions affords a wide discretion and therefore an opportunity for discrimination and favoritism difficult, if not impossible, to detect.

The Court of Appeals rightly said that the Exchange's contention "that there is no possiblity of favoritism" is "unrealistic" (18a).**

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* Including the eight brought by respondent.

** The alleged impossibility of favoritism was the principal argument of the Exchange. Neither respondent nor the Exchange urged the advance waiver theory.

The Tactics of Exchange Members are such that Statutes Requiring Fair Procedures Should be Strictly Enforced.

The President of the Exchange, Mr. Robert W. Haack, recently admitted that many members of the Exchange engage in sharp practices. As quoted in the public press, according to its President, "... many of [the Exchange's] own members indulged in 'intrigues and machinations' and 'mazes of blatant gimmickry' to bypass the rules and subvert the central market place when they spied a chance for a profit." Newsweek magazine, issue of November 30, 1970, page 72.

POINT I

It is peculiarly anomalous that a relevant statute forbidding "unfair means" and "evident partiality" should be held subordinated to provisions in the contracts of an institution which is the subject of a special statute intended to ensure that "fair procedures" and the "highest ethical standards" prevail in all its activities.

In *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963), the Court, at page 350, quoted with approval from the House of Representatives report proposing the enactment of the Securities Exchange Act of 1934 to the effect that the Exchange is "*affected with the public interest* in the same degree as any other great utility." The Court then pointed out the evolution of the status of the Exchange from that of private club to public utility, saying at pages 350-351 that historically securities exchanges had been "treated by the court as private clubs [but that] as exchanges became more and more important in our Nation's economic and financial system, however, the private-club analogy became increasingly inapposite."

Continuing with the discussion of problems presented by the facts of *Silver*, viz., the revocation of the wire service of a non-member firm, the Court ruled that the scheme of self-regulation authorized by Congress by the statute "cannot be thought to have sanctioned and protected self-regulatory activity when carrier out in a fundamentally unfair manner" (page 364). The Court ruled that it was "essential" "that the highest ethical standards prevail as to every aspect of the Exchange's activities" (page 366).

In *Silver* the Court set aside the action of the Exchange because it had not been carried out according to "fair procedures" dictated by the "highest ethical standards."

Thus, applying the doctrine of *Silver* to the facts of this case, shall we understand that the Exchange's self-regulatory authority is to be deemed to "sanction" and "protect" an activity by which disputes are disposed of by "undue means" and "evident partiality"?

The theory of waiver adopted in this case would, in fact, if valid, have been equally applicable in *Silver*. The plaintiff in that action presumably knew, certainly he was on notice, that under the then existing rules of the Exchange his wire service could be summarily discontinued. That fact was not held to lessen his statutory right to "fair procedures."

In the present case a statute construed by this Court two years ago specifically commands "fair procedures"—yet the Court of Appeals, on the theory of advance waiver, fails to enforce petitioner's statutory right to a tribunal free from "impression of possible bias" at a moment when the President of the Exchange is publicly bewailing the "intrigues and machinations" and "mazes of blatant gimmickry" in which the members engage.

POINT II

When there is an inconsistency between a contract and a relevant statute, the statute controls. The party is not deemed to have waived his statutory rights by making the inconsistent contract.

As the Court of Appeals correctly said:

> "Under § 28(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(b), the arbitration procedures of the Exchange are subject to existing law, which of course includes the provisions of the Arbitration Act and, in particular, § 10 of that Act as interpreted by the Supreme Court."

Petitioner's membership in the Exchange and its own partnership agreement were New York contracts, and as such any provisions inconsistent with existing and applicable statutes were nugatory to the extent of the inconsistency.

In *People ex rel. City of New York* v. *Nixon*, 229 N.Y. 357 (1920), the Court considered the jurisdiction of the public service commission over the rate of fare provided in a municipal franchise contract with a traction company entered into at a time when New York law provided that rates should be "reasonable"; claiming that the stipulated rate of fare provided an insufficient return on the investment, the company's receiver applied to the commission for an increased fare. The City of New York moved to dismiss for want of jurisdiction, contending that the contract rate of fare conclusively governed. The Court, in an opinion by Cardozo, J., later a member of this Court, said (pages 361-362):

> "The obligation of a contract is determined by the law in force when it is made . . . Statutes then existing are read into the contract. They enter by implication into its terms. They do not change the obligation. They make it what it is. The statute

> which clothed the commission with jurisdiction to increase fares if found to be inadequate, was notice to municipalities that franchises thereafter granted must be coupled with the jurisdiction thus conferred . . . We have held that [the regulatory statute did not] nullify existing contracts. We are now asked to hold that the municipalities by their contracts may nullify existing statutes. We will not go so far."

The Court held that the statute controlled over the contract and that the commission had jurisdiction. It most definitely did *not* hold that the traction company had waived its rights to a reasonable return by making a contract for a particular rate of fare.

This Court reached the same result in a number of cases. *Southern Iowa Electric Co.* v. *Chariton*, 255 U.S. 539 (1921); *San Antonio* v. *Public Service Co.*, 255 U.S. 547 (1921); *Ortega Co.* v. *Triay*, 260 U.S. 103 (1922). The Court's headnote in *Ortega* correctly stated the holding of the case as follows (page 103):

> "A covenant to operate at a certain fare, made by the vendee in consideration of the sale of an electric railroad, cannot prevent a change of fare directed by public authority, acting in the public interest, under laws existing when the covenant was made."

There were many other cases of this type in both the state and federal courts when existing contract rates became unremunerative because of the rise in prices following the First World War. In none was it held that statutory rights were waived by making an inconsistent contract.

POINT III

Not only are advance waivers of statutory rights invalid as a matter of contract law, but in this instance § 29(a) of the Securities Exchange Act specifically invalidates waivers of rights granted by the Act.

As this Court said in *Brooklyn Savings Bank* v. *O'Neill*, 324 U.S. 697, 704 (1945):

> "It has been held in this and other courts that a statutory right conferred on a private party, but affecting the public interest, may not be waived or released if such waiver or release contravenes the statutory policy."

A waiver of damages for failure to receive minimum wages was there held void as contravening the statutory policy.

Thus advance waivers of the statute of limitations, of an infant's right to invalidate his contract or of a contracting party's right to challenge a contract for fraud or duress are all void. 6A Corbin, *Contracts* (1960 ed.), § 1515. In *Pope Manufacturing Co.* v. *Gormully*, 144 U.S. 224 (1892), this Court held invalid the waiver by a patent licensee of his right to plead the invalidity of the patent if sued for infringement.

In this case § 29(a) of the Securities Exchange Act of 1934, *supra* page 3, forbids any "provision binding any person to waive compliance with any provision of this Act."

By § 28(b) of the Act, *supra* page 3, the Arbitration Act is in substance absorbed into the Securities Exchange Act of 1934—as the Court of Appeals noted in the passage quoted *supra* page 11. Thus the waiver is void under the Securities Exchange Act of 1934.

This Court reached an analogous conclusion as regards an alleged waiver of arbitration under the corresponding and identically phrased provision of the Securities Act of 1933. *Wilko* v. *Swan*, 346 U.S. 427 (1953).

Conclusion

The Court of Appeals has, petitioner submits, again adopted the private club approach to the affairs of the New York Stock Exchange and has, we believe, erroneously carved out an enormous exception to this Court's construction of § 10 of the Arbitration Act.

This Court should grant a writ of certiorari, reverse the judgment of the Court of Appeals and direct that the arbitrators be required to disclose all their dealings with Spear, Leeds & Kellogg.

Respectfully submitted,

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New York
December 8, 1970

(APPENDIX)

Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

69 Civ. 264

In the Matter of the Arbitration between
GARFIELD & Co.,

Petitioner,

and

FRANCIS J. WIEST,

Respondent.

Appearances:

BAKER, NELSON, WILLIAMS & MITCHELL, Attorneys for Petitioner, 20 Exchange Place, New York, New York 10005, C. DICKERMAN WILLIAMS, LESLIE KIRSCH, of Counsel.

GRANDFIELD & GOODMAN, Attorneys for Respondent, 15 William Street, New York, New York 10005, MORTIMER GOODMAN, of Counsel.

MILBANK, TWEED, HADLEY & MCCLOY, Attorneys for *amicus curiae* New York Stock Exchange, 1 Chase Manhattan Plaza, New York, New York 10005, ANDREW J. CONNICK, of Counsel.

McGOHEY, *D.J.*

The petitioner, a member firm of the New York Stock Exchange, moved purusant to the Arbitration Act[1] to

[1] 9 U.S.C. § 6.

vacate an award made in an arbitration between it and a former general partner, also a member of the Exchange. The respondent opposed on jurisdictional and other grounds and later, while the motion was under consideration, moved on jurisdictional grounds for remand to the New York Supreme Court, or in the alternative for entry of judgment on the award. Both motions are here considered. The Exchange, with leave of the court, filed an amicus brief and argued in opposition to the petition and in support of the award. The petitioner's motion is denied. The respondent's motion for judgment is granted.

The arbitration involved the respondent's claim for money allegedly due him upon his withdrawl from the petitioner and the latter's counterclaim for damages resulting from the respondent's alleged disloyalty in violation of the parties' partnership agreement. The arbitrators awarded the respondent $68,965.29, assessed $600 costs against the petitioner and dismissed its counterclaim. The petition alleges the award was procured by "undue means" or "evident partiality" in the arbitrators.[2]

The petitioner is a limited partnership organized under New York law. It consists of three general partners and one limited partner. The general partners are all citizens of New Jersey.[3] The respondent is a citizen of New York. The amount in controversy exceeds $10,000 exclusive of interest and costs.

The fourth article of the partnership agreement provides: "The copartnership shall conduct a business of general brokerage in stocks, bonds and other securities

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[2] Id. § 10.

[3] Respondent's Ex. 1, p. 2. This exhibit shows the limited partner also is a citizen of New Jersey although that is immaterial since the object of this proceeding is not "to enforce a limited partner's right against or liability to the partnership." New York Partnership Law § 115; Colonial Realty Corporation v. Bache & Co., 358 F.2d 178, 183-4 (2d Cir. 1966).

and in commodities usually traded or dealt in on National Exchanges and in the over the counter markets, and in the purchase, sale, investment and dealing in stocks, bonds and other securities and in commodities and in acting as specialists on National Exchanges; and, in general the copartnership shall engage in such business as is usually conducted by Exchange brokers, securities dealers and Exchange specialists in the City of New York and whereever else the firm hereafter do business."[4] The twenty-fifth article of the partnership agreement provides: "Any controversy or claim arising out of, or relating to, this agreement or the breach thereof, or to any matter in connection therewith, shall be settled in New York City by arbitration in accordance with the Constitution and Rules then obtaining of the New York Stock Exchange, and judgment upon the award rendered may be entered in the highest court of the forum, State or Federal, having jurisdiction."[5] The business described in the fourth article which the parties carried on for more than six years certainly involved interstate commerce[6] and it is clear that, "at the time [the parties] entered into [the partnership agreement] and accepted the arbitration clause, they *contemplated* substantial interstate activity."[7] The controversy between them arose out of that agreement and therefore is within the terms of the Arbitration Act.[8]

The court has jurisdiction.

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[4] Petitioner's Ex. A, p. 2.

[5] Petitioner's Ex. T, p. 15.

[6] 15 U.S.C. § 78b. See also U.S. v. Re, 336 F.2d 306, 315 (2d Cir.), cert. denied, 379 U.S. 904 (1964).

[7] Metro Industrial Painting Corp. v. Terminal Construction Co., Inc., 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, Chief Judge, concurring).

[8] 9 U.S.C. §§ 1, 2.

The arbitration was conducted in accordance with the Constitution and Rules of the Exchange which requires that controversies between members be submitted for arbitration by five members of the Board of Arbitrators of the Exchange. This board consists of fifteen members of the Exchange appointed after each annual election by the Chairman of the Board of Governors, subject to that board's approval.

Prior to the respondent's withdrawal from the petitioner he was its floor specialist in a small number of securities. Shortly after his withdrawal he became a partner and floor specialist of Spear, Leeds and Kellogg, a prominent member firm whose members or representatives are floor specialists in a large number of securities. James C. Kellogg of that firm was, at some unspecified prior time, Chairman of the Board of Governors of the Exchange. It was not shown nor indeed was it contended that he appointed any of the arbitrators who sat in this case to the Board of Arbitrators or that he or anyone in his firm or on his behalf caused any of them to be so appointed; or to be chosen to serve in this case. Those who served here appear to have been chosen to do so by the Arbitration Director of the Exchange who was neither alleged nor shown to have been appointed by or otherwise associated with Mr. Kellogg. As far as appears, the Director first disclosed the names and firms of the panel members to the parties in the notice of the first hearing which he gave them about two weeks before the appointed date. The notice contained the following statement: "Should any party or counsel believe an arbitrator disqualified for any cause, he should notify the Arbitration Director at once."[9] The notice was accompanied by a document entitled Arbitration Procedures Pamphlet which contained the following provision: "Upon receipt of the notice, a party may challenge

[9] Respondent's Ex. IV, p. 2.

any arbitrator for cause by written notice to the Arbitration Director. If the challenge is sustained by the Arbitration Director, another arbitrator will be chosen as a replacement."[10] Neither party challenged an arbitrator either in writing or otherwise in the period between receipt of the notice and the first hearing.

At the start of the first session the petitioner's counsel moved the arbitrators orally on two grounds to dismiss the proceeding and remit the parties to their demedies at law, pursuant to the following provision in Section 7 of Article VIII of the Exchange's Constitution: "The arbitrators in any case may at any time during the proceedings, and shall upon the joint request of the parties thereto, dismiss the proceedings and refer the parties to their remedies at law."[11] The respondent did not join in the motion. Counsel for the petitioner stated his first ground as follows:

> "a party of the other side, a partner of Mr. Wiest, a person whose conduct I shall feel called upon to criticize in the course of the proceedings, is a very well known member of the Exchange, Mr. Kellogg, former Chairman of the Board of Governors. Mr. Garfield, on the other hand, is a relatively little known member of the Exchange and I doubt very much if any of you have had occasion to do business with him. On the other hand, I am sure that you all have had occasion to do business, and perhaps regularly do business, with Spear, Leeds & Kellogg, of which Mr. Kellogg is the leading partner.
>
> "I do not want to seem to reflect upon your fairness and the honesty and the confidence with which you will approach the issues in this case but I do suggest, however, under such circumstances as exist here, it is a kind of embarrassment dealing, on the one side, with a person one knows, with one whose

[10] Respondent's Ex. V, p. 7.

[11] Respondent's Ex. II, p. 3.

> firm does business with and, on the other hand, a person of whom one knows very little, perhaps have never known of at all until this proceeding came along."[12]

The second ground of the motion was that the controversy involved legal principles whose application although "relatively simple for a court of law might prove to be difficult for [the arbitrators.]" The only arbitrator who commented on the motion was the panel chairman who said: "On behalf of the Arbitrators, I am going to take enough time to assure you that the position to which you referred of knowing one man is entirely familiar to the Arbitrators and I don't think any of them have favoritism on their con sciences. I say that just to reassure you."[13] The arbitrators then went into executive session after which the chairman announced their denial of the motion. The proceeding was later concluded after several hearings without further challenge to the arbitrators.

The petitioner has not charged either corruption or actual bias in the arbitrators. Its contention on this motion is, rather, that the award must be vacated because, although the matter was brought to their attention by the motion just described, "the respective Arbitrators did not disclose to the petitioner their business dealings with the Kellogg firm, though any such dealings, in the nature of things, were known to the Kellogg firm of which respondent was a member."[14] *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*[15] on which the petitioner relies was decided eight months before the instant arbitration hearings commenced and one month before the challenged

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[12] Petition, pp. 9-10, par. 34.

[13] Answer, pp. 6-7, par. Seventeenth.

[14] Petition, p. 11, par. 36.

[15] 393 U.S. 145 (1968).

award was made. As far as appears it was not brought to the arbitrators' attention prior to the award.

Commonwealth involved a proceeding under the Arbitration Act in which the parties were a painting subcontractor and the sureties of the prime contractor on a large building construction project in Puerto Rico. The subcontract contained an arbitration clause pursuant to which each party designated one arbitrator and these two selected a third. Although the prime contractor was a "regular customer" of the third arbitrator, having employed him from time to time as an engineering consultant and paid him fees of approximately $12,000 over a period of four or five years, these facts were unkown to Commonwealth "and were never revealed to it by this arbitrator, by the prime contractor, *or by anyone else* (emphasis supplied) until after the award had been made." [16] Commonwealth's motion to vacate the award on the ground, among others, of the arbitrator's failure to disclose his business relationship with the prime contractor was denied by the District Court and the Court of Appeals for the First Circuit affirmed.[17] Both courts found there was no "prejudice or bias in fact manifested in the course of the proceedings," [18] a claim which Commonwealth asserted in those courts but abandoned in the Supreme Court.[19] While the Court of Appeals thought "it would have been far better if there had been disclosure" it was unable to "say that the relationship was sufficiently close to establish 'evident partiality' within the statute as a matter of law." [20]

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[16] 393 U.S. 146.

[17] 382 F.2d 1010 (1 Cir. 1967).

[18] Id. 1012.

[19] 393 U.S. 147.

[20] 382 F.2d 1012.

The Supreme Court rejected the lower court's construction of the statute and reversed. It had no doubt that "if a litigant could show that a foreman of a jury or a judge in a court of justice had, *unknown to the litigant* (emphasis supplied), any such relationship, the judgment would be subject to challenge" [21] in light of the court's decision in *Tumey* v. *Ohio.*[22] The Supreme Court there reversed, as a denial of due process, a criminal conviction by a village mayor because the only compensation he received for his judicial services consisted of the statutory fees, amounting to about $100 a month,[23] he assessed against those he convicted. The *Commonwealth* court could "see no basis for refusing to find the same concept [embodied in this application of the constitutional principle to courts] in the broad statutory language that governs arbitration proceedings and provides that an award can be set aside on the basis of 'evident partiality' or the use of 'undue means'." [24] It held the failure of both the arbitrator and the prime contractor to give Commonwealth "even an intimation" of their close financial relations, a "manifest violation of the strict morality and fairness Congress would have expected [on their part]" [25] and ruled that "arbitrators [should] disclose to the parties any dealings that might create an impression of possible bias." [26]

The facts here are substantially and materially different from those in Commonwealth. While the instant petition charging, on information and belief (par. 32),

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[21] 393 U.S. 148.

[22] 273 U.S. 510 (1927).

[23] Id. at 532.

[24] 393 U.S. 148.

[25] Id. at 147-148.

[26] Id. at 149.

that the "members of both the Board and the panel of arbitrators . . . or their firms, regularly conducted business with the Kellogg firm of which respondent was a partner in amounts *more than trivial*[27] in securities [in which Wiest and the Kellogg firm were specialists] both before and during the arbitration," (emphasis supplied) was not filed until after the award, it is not and indeed could not be contended that the "information" was acquired and the "belief" formed only *after* the award. As already noted, the petition (par. 34) shows that when the parties first appeared before the arbitrators, the petitioner's counsel was "*sure*" that all of the latter had "had occasion to do business, and perhaps regularly do business with Spear, Leeds and Kellogg. . . ." (emphasis supplied). Accordingly, that there had been in the past and currently were, "more than trivial" business relations between the arbitrators and the Kellogg firm, was thus known to Garfield & Co. at that time at least, and it is to the last degree improbable that it lacked this knowledge two weeks earlier when the names of the members of the panel appointed by the Arbitration Director were disclosed to it. Although the petitioner had sufficient information on which to base a challenge, it did not file one with the Arbitration Director before the hearings commenced, as it was entitled and indeed invited to do. Significantly, even the motion it made at the first hearing did not challenge any arbitrator's integrity or seek his disqualification by reason of possible interest. On the contrary, counsel specifically disclaimed any purpose "to reflect upon [their] fairness and . . . honesty." He was clearly concerned, as the second ground of his motion shows, to have the controversy tried by a court rather than arbitra-

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[27] The phrase appears to have been taken from Justice White's concurring opinion in Commonwealth in which Justice Marshall joined, 393 U.S. 151-152.

tors. Accordingly, it seems clear and this court finds that, while unwilling to challenge any of them, he hoped to persuade all of them to remit the controversy to the State Court in order to spare themselves any embarrassment they might experience if they should have to decide against a member of the Kellogg firm. In view of counsel's sophisticated statement, it would have been the merest formalism for the arbitrators to respond to his argument by repeating to him the facts he had just recited about their business relations with that firm; facts which they, by not denying, in effect admitted. They did not, it is true, disclose the number or dollar value of their respective dealings with the Kellogg firm but, in the circumstances, such detail was by no means essential for a legally sufficient challenge. The petitioner, although sufficiently informed to be able to do so, chose, for its own reasons, not to make any challenge. Now that it has lost in the arbitration, it should not be heard to claim that the arbitrators' conduct denied it the opportunity to make what we find to have been a free and informed choice.

The respondent's motion to dismiss for lack of jurisdiction is denied and it is So Ordered.

The petitioner's motion to vacate the award is denied and it is So Ordered.

The respondent's motion for entry of judgment on the award is granted and judgment may be entered accordingly.

It is So Ordered.

Dated: New York, N. Y.,
January 16, 1970.

JOHN F. X. McGOHEY
U. S. D. J.

Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 22—September Term, 1970.

(Argued September 16, 1970—Decided October 20, 1970.)

Docket No. 34552

In the Matter of the Arbitration Between
GARFIELD & Co.,
Petitioner-Appellant,
and

FRANCIS J. WIEST,
Respondent-Appellee.

Before:
WATERMAN, MOORE and KAUFMAN, *Circuit Judges.*

Appellant seeks reversal of (1) an order of the United States District Court for the Southern District of New York, McGohey, *J.*, denying its petition to vacate an arbitration award made against it and (2) a judgment by the same court confirming the arbitration award for appellee. Affirmed.

C. Dickerman Williams, Leslie Kirsch, Baker, Nelson, Williams & Mitchell, New York City, *for Appellant.*

Mortimer Goodman, Grandefeld & Goodman, New York City, *for Appellee.*

Andrew J. Connick, Milbank, Tweed, Hadley & McCloy, New York City, *for amicus curiae New York Stock Exchange.*

Waterman, *Circuit Judge*:

These are appeals from (1) an order of the United States District Court for the Southern District of New York denying the petition of Garfield & Co. (Garfield) to vacate an arbitration award made against it, and (2) a judgment by the same court in favor of the cross-petitioner, Francis J. Wiest, and against cross-respondent Garfield for $73,447.95. The judgment and order were made on an opinion by McGohey, *J.*, reported in 308 F.Supp. 1107 (1970).

Petitioner-appellant Garfield is a member firm of the New York Stock Exchange (Exchange). It is a small firm with three general partners and one limited partner. Respondent-appellee had formerly been a partner in Garfield & Co. but resigned and joined another member of the Exchange, the firm of Spear, Leeds & Kellogg. The latter is a large firm and was a specialist in 61 stocks, some of which were quite actively traded, before Wiest joined the firm. Mr. Kellogg, the leading partner of the firm, is a former Chairman of the Board of Governors of the Exchange.

The present dispute arose out of the above-mentioned change of firms by Wiest. Seeking his share of the proceeds of the transfer of an Exchange membership and certain salary and other amounts due him under the terms

of the Garfield & Co. partnership agreement, Wiest sent the Arbitration Director of the Exchange a claim against Garfield for $75,719, exclusive of interest and costs. Garfield denied most of this liability and counterclaimed for $250,000 damages for the business expectancy in certain listed stocks in which Wiest had become the Exchange specialist by the use of funds allegedly provided by Garfield. The theory of the counterclaim was that there had been a conspiracy entered into between Wiest and Mr. Kellogg while Wiest was a partner in Garfield by which Wiest would leave Garfield and join Spear, Leeds & Kellogg, taking with him the status of specialist in eight stocks.

Under the Exchange Constitution and Rules and the Garfield partnership agreement there were clearly defined arbitration procedures. The Garfield partnership agreement provided in part:

> Any controversy or claim arising out of, or relating to, this agreement . . . shall be settled in New York City by arbitration in accordance with the Constitution and Rules then obtaining of the New York Stock Exchange. . . .

Article VIII, Section 5, of the Exchange Constitution provides:

> Any controversy between parties who are members, allied members, member firms or member corporations shall be submitted for arbitration to five Arbitrators, members of the Board of Arbitration provided for by Section 4 of this Article, and the decision of a majority of such Arbitrators shall be final. All such proceedings shall be held in the City of New York.

Article VIII, Section 4, provides in pertinent part:

> Promptly after the annual election of the Exchange, the Chairman of the Board of Governors

> shall appoint, subject to the approval of the Board of Governors, a Board of Arbitration to be composed of fifteen arbitrators selected from members and allied members of the Exchange who are not members of the Board of Governors, to serve at the pleasure of the Board of Governors or until the next annual election of the Exchange and their successors are appointed and take office.

The Arbitrations Director selects five members of this Board as a panel for any particular arbitration. Article VIII, Section 7, provides in part:

> The Arbitrators in any case may at any time during the proceedings, . . . dismiss the proceedings and refer the parties to their remedies at law. . . .

The Arbitration Procedures Pamphlet, distributed to the parties, states:

> Upon receipt of the notice [giving the names and addresses of the arbitrators and the date, time and place of the hearing], a party may challenge any arbitrator for cause by written notice to the Arbitration Director. If the challenge is sustained by the Arbitration Director, another arbitrator will be chosen as a replacement.

The Procedures Pamphlet specifically stated that "[i]t neither interprets the relevant portions of the Constitution and Rules nor is a substitute therefor."

As noted above, Wiest initiated the arbitration proceeding by filing a statement of claim with the Arbitration Director. Garfield filed an answer including the counterclaim, and the parties signed a submission agreement for an arbitration to be conducted in accordance with the Exchange Constitution and Rules. After the parties had submitted statements of their respective claims to the Arbitration

Director, he sent them the notice (mentioned in the Procedures Pamphlet above) setting the hearing for March 7, 1968 and enclosed a copy of the Procedures Pamphlet. Garfield received this notice during the last week of February 1968. At no time did Garfield challenge any of the arbitrators for cause under the above quoted passage of the Procedures Pamphlet. Instead, at the opening of the arbitration hearing Garfield made a motion to have the arbitrators dismiss the proceedings and remit the parties to their remedies at law under the provisions of Article VIII, Section 7, of the Exchange Constitution. The primary ground for this motion was that the arbitrators might be embarrassed in deciding a case in which the firm of Spear, Leeds & Kellogg (Mr. Kellogg in particular), a firm with which the arbitrators presumably did substantial business, would be severely criticized by a relatively small and unknown firm. After assurances by the chairman of the panel about lack of bias, the motion was denied and the hearings began. The hearings continued through November 20, 1968 and, on December 19, 1968, the arbitrators made an award in Wiest's favor.

On November 18, 1968, while this case was being presented to the arbitrators, the Supreme Court handed down its decision in *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968), that an arbitration award must be vacated under § 10 of the Arbitration Act, 9 U.S.C. § 10,[1] where a "neutral" arbitrator had failed to disclose

[1] 9 U.S.C. § 10 provides in pertinent part:

In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(a) Where the award was procured by corruption, fraud, or undue means.

(b) Where there was evident partiality or corruption in the arbitrators, or either of them.

substantial dealings with one of the parties. In January 1969 Garfield, relying upon the holding of *Commonwealth Coatings*, filed a petition in the district court below to vacate the award. In August 1969 Wiest filed a petition in the Supreme Court, New York County, to confirm the award in his favor. Garfield removed Wiest's state court petition to the district court, and Wiest sought a remand back to the state court or, alternatively, a confirmation of the award by the district court. In January 1970 the order and judgment mentioned at the beginning of this opinion were entered, and Garfield filed this appeal.

Garfield contends that *Commonwealth Coatings* is fully applicable to Exchange arbitration; that it timely raised at the commencement of the arbitration hearings its objection to continuing before the arbitration panel; and that the award should be vacated because the arbitrators did not disclose their almost certain dealings with Spear, Leeds & Kellogg, and with Mr. Kellogg. While we do not fully disagree with all of appellant's contentions, we affirm on the ground that, in the context of Exchange arbitration, the particular type of transactions to which Garfield objects need not be disclosed.

In *Commonwealth Coatings* the parties, under the contract giving rise to the dispute therein, had agreed to submit any controversies to arbitration. Pursuant to this agreement each party appointed an arbitrator, and these two together selected a third, supposedly neutral, arbitrator. Unknown to the petitioner in that case, the third arbitrator, in his business as an engineering consultant, had done significant and repeated business with the other party. This relationship between the arbitrator and the other party was not discovered by the petitioner until after an award was made. The aggrieved party sought vacation of the award in federal court under § 10 of the Arbitration Act, and relief was denied by both the district

court and the court of appeals. The Supreme Court reversed despite the fact that the arbitration award had been unanimous and no claim had been made at any time that there had been any actual partiality, unfairness, bias, or fraud. 393 U.S. at 152 (dissenting opinion of Fortas, J.), and see lower court opinion, 382 F.2d 1010, 1012 (1 Cir. 1967).

Initially we must consider whether Garfield's objections to the arbitration panel were properly and timely raised. It is well settled that disgruntled losers cannot first raise their objections after an award has been made. *Ilios Shipping Corp.* v. *American Anthracite Corp.*, 148 F. Supp. 698 (SDNY 1957), *aff'd*, 245 F.2d 873 (2 Cir. 1957); *San Carlo Opera Co.* v. *Conley*, 72 F. Supp. 825, 833 (SDNY 1946), *aff'd*, 163 F.2d 310 (2 Cir. 1947). Here Garfield did not challenge any of the arbitrators for cause as provided in the Arbitration Procedures Pamphlet but instead made a motion under Article VIII, Section 7, of the Exchange Constitution for the arbitrators to remit the parties to their legal remedies. Garfield urges that the provision for challenges for cause in the Procedures Pamphlet was nugatory in that such challenges were not provided for in the Exchange Constitution and Rules. Without passing on this contention we do accept Garfield's second argument that, under the then existing law, business dealings with the parties were not deemed cause for challenge. *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 393 U.S. 145, 153 (1968) (dissenting opinion of Fortas, J.); *Commonwealth Coatings Corp.* v. *Continental Casualty Co.*, 382 F.2d 1010 (1 Cir. 1967); *Ilios Shipping Corp.* v. *American Anthracite Corp.*, *supra* at 700; *Stiers Bros.* v. *Broderick*, 60 F. Supp. 792, 799 (D. Kan. 1945); *Astoria Medical Group* v. *Health Insurance Plan*, 11 N.Y.2d 128, 136, 13[illegible] (1962), and hence that Garfield should not be faulted for failure to make a challenge for cause. Contrary to the opinion below, we find that Garfield's motion at the begin-

ning of the arbitration hearing properly and timely raised its objections under the circumstances and the then existing state of the law. Needless to say, a more specific objection would be required after the *Commonwealth Coatings* decision, but on these facts Garfield cannot be held to a precise prediction of future case law.

Returning to the merits, *Commonwealth Coatings* teaches that when parties agree to arbitration, the arbitrators, in order to avoid even the appearance of bias, must disclose any nontrivial dealings with one party which are not known to the other party. A necessary corollary is that, once disclosure has been made, the arbitrator may be challenger for cause if the dealings are nontrivial. The obverse of this last proposition is that when such challenges are waived in advance by the parties as to certain transactions, arbitrators are not required to disclose participation in such transactions.

In the present case Garfield urges that since the arbitrators did not reveal the exact extent of their dealings with Spear, Leeds & Kellogg in those stocks in which the latter were specialists and did not reveal dealings with Mr. Kellogg as a former Chairman of the Board of Governors, there was no proper disclosure. We disagree for we find that such objections were waived in advance by Garfield and by all other members of the Exchange.

Garfield, when becoming a member firm of the Exchange, agreed to the arbitration of disputes according to the Exchange Constitution and Rules. The selection of the arbitration panels was known to it, and it most certainly knew that any arbitrators, by their very connection with the Exchange, would, in the ordinary course of business, have dealings with specialists, and that Exchange arbitrators would usually have more substantial contacts with large member firms than with smaller member firms. While we find rather unrealistic the Exchange's contention in its *amicus* brief that there is no possibility of favoritism by

specialists, it would appear that any objections to arbitrators based upon their dealings through specialists are waived by member firms when they agree to Exchange arbitration; such dealings are contemplated by the parties when they join the Exchange. In *Commonwealth Coatings* the parties agreed to the selection of a neutral third arbitrator, one without any nontrivial connections with either party; in the present case Garfield agreed to arbitration before a panel of arbitrators who almost necessarily will have had dealings in the ordinary course of Exchange business with any potential opposing party who is also a member of the Exchange.

Similarly, when becoming an Exchange member, Garfield knew that if it should ever become involved in a dispute that concerned a former Chairman of the Board of Governors, it would be probable that the arbitrators might have had some dealings with the former Chairman. Although Garfield points to the provisions in Article VIII, Section 7, authorizing the arbitrators to remit the parties to their legal remedies, Garfield is not objecting so much to the qualifications of the arbitrators as to their likely business connections with its opponent. While we do not pretend to interpret Article VIII, Section 7, we do think that the provision must have been intended to give an alternative remedy, not because of the connections of a party, but because of the possible legal difficulties in the issues of a particular case or because of individual disqualifications of the arbitrators, neither of which appear to be present in this case. Otherwise, disputes involving certain of the larger, or more active, or more specialized, firms would be routinely remitted to the courts.

Inasmuch as Garfield has made no claim that there were dealings between the arbitrators and Spear, Leeds & Kellogg or Mr. Kellogg other than in the ordinary course of Exchange business, *Commonwealth Coatings* does not require the vacation of the award in this case. However,

we wish to emphasize that we do not hold that Exchange arbitration is exempt from the holding in *Commonwealth Coatings* insofar as an arbitrator is required to disclose any dealings he may have had with a party which were dealings *not* in the ordinary course of Exchange business. Under § 28(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(b), the arbitration procedures of the Exchange are subject to existing law, which of course includes the provisions of the Arbitration Act and, in particular, § 10 of that Act as interpreted by the Supreme Court. In this opinion we are only holding that, when parties have agreed to arbitration with full awareness that there will have been certain, almost necessary, dealings between a potential arbitrator and one of the opposing parties, disclosure of these dealings is not required by *Commonwealth Coatings* inasmuch as the parties are deemed to have waived any objections based on these dealings.

The order and judgment of the district court are affirmed.